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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1955

No.

WELLS FARGO BANK & UNION TRUST CO., as Executor of the Estate of Ivey L. Borden, Deceased,
Petitioner,

vs.

UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI
to the United States Court of Appeals for the Ninth Circuit.

Petitioner, the executor of the Estate of Ivey L. Borden, Deceased, by its counsel, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, affirming the decision of the United States District Court for the Northern District of California, Southern Division.

OPINIONS BELOW.

The opinion of the District Court is reported in 115 F. Supp. 655, and is printed in the Supplemental Transcript (R. 241, et seq.). The opinion of the Court of Appeals is reported in 225 F. 2d 298, and is printed in Appendix B hereto.

JURISDICTION.

The judgment of the Court of Appeals was entered on June 16, 1955 (R. 239). A timely petition for rehearing filed on July 15, 1955 was denied on September 6, 1955 (R. 239). The jurisdiction of this Court is invoked under 28 U.S. Code, Section 1254(1).

QUESTIONS PRESENTED.

1. Whether the price paid for real property at a foreclosure sale establishes the fair market value of that property, where the property is purchased for the account of the sole shareholder of the debtor over the bid of a single outsider.

2. Whether the price paid for real property at a foreclosure sale is evidence of the fair market value of that property, where the property is purchased for the account of the sole shareholder of the debtor over the bid of a single outsider.

3. Whether the sole shareholder in a corporation loses his proprietary interest, for purposes of the proprietary interest test applied in tax-free reorganizations, when the

corporation becomes insolvent, even though the creditors acquiesce in his continuing to exercise the rights of a proprietor and do not seek to wrest them from him.

4. Whether a court of appeals may reject unimpeached, uncontradicted evidence not inherently improbable in character, where the district court made findings accepting that evidence.

STATUTES INVOLVED.

The statutes involved are Sections 112(b)(4), 112(i), and 113(a)(7) of the Revenue Act of 1932, and Sections 113(a)(12) and 718(a)(2) of the Internal Revenue Code of 1939 as in effect in the taxable years 1941 to 1943, inclusive. They are printed in Appendix A.

STATEMENT OF THE CASE.

At all times between March 1, 1913 and his death in 1949, Mr. Ivey L. Borden owned the entire proprietary interest in Victoria Island, either through individual ownership or through the media of corporations entirely owned by him, with the possible exception of a period in 1932 and 1933 (R. 196-197; R. 39, 47; Exh. VII, R. 130-140). The status of his interest in the latter period is the point on which this case turns.

Victoria Island is a reclaimed island in the delta of the San Joaquin River in California, approximately 7,313 acres in extent (R. 196). It is surrounded by a levee

which holds back the river waters (R. 25, 32). Between 1913 and 1933 it was continuously subject to bonds of one sort or another in the principal amount of $600,000 (R. 208, 38, 39, 197). In 1929 Mr. Borden organized I. L. Borden Company and transferred Victoria Island to it in exchange for all its stock. The corporation also issued its first deed of trust bonds in the face amount of $600,000 to the holders of the bond indebtedness on the island. (R. 38, 197.)

As the end of 1932 approached, the situation was this: the principal of the bonds had been reduced to $588,000 by the retirement of some of them; the corporation had refinanced the interest for 1932 by issuing notes for it; the sinking fund requirements had been waived until 1934; agricultural conditions continued so bad that Mr. Borden was doubtful that the corporation would be able to meet its interest payments for 1933 (R. 104, 197; Exhs. 1-A, 1-B, 1-C, R. 51-71). Accordingly, he had begun negotiations for a means of refinancing the bonds, and by August, 1932 had reached a preliminary understanding with the West Coast Life Insurance Company for a loan to the corporation of $200,000 to be used to buy up the bonds (R. 213-214).

At this stage, Mr. Hadsell, Mr. Borden's attorney, was called in to handle the transaction, and he informed the members of an adjustment committee, which had negotiated the prior standby agreements on behalf of the bondholders, of the developing plan (R. 212-217). The adjustment committee advised Mr. Hadsell that it probably would be unable to get unanimous consent of the bondholders to the adoption of any plan, and as the plan

then being considered would fail without it, a substitute was adopted (R. 198, 217).

The substitute plan contemplated that the foreclosure sale power of the trustee under the bond issue would be utilized, assuming that a majority of the bondholders agreed to the plan (R. 197-198, 216-217). The insurance company felt that for its own protection it could not agree to the use of a foreclosure sale to terminate the bondholders' interests, unless a new corporation were formed to acquire the property at the foreclosure sale. Accordingly, the plan was altered to meet this requirement. (R. 221.)

The plan evolved by the insurance company and Mr. Borden's attorney, with the consent and assistance of the adjustment committee, was carried out. In due course the holders of $454,000 of bonds out of the total outstanding $588,000 of bonds signified their consent to the plan by depositing their bonds. (R. 218.) Pursuant to the request contained in the agreement by which the bondholders signified their acceptance of the plan, the trustee declared a default and scheduled a sale of the island (R. 132, 220). The sale occurred, the island was bought in for Mr. Borden's account with funds supplied by the insurance company, and the only departure from the plan was the appearance of an outside bidder, who ran the sale price up by about $40,000 (R. 136, 220).

The portions of the record which most succinctly set forth the plan summarized above are the deposit agreement which each consenting bondholder signed (Exh. 1-F, R. 75-79), the letter from the I. L. Borden Company to the bondholders urging that they sign that agreement

(Exh. II, R. 80-83), and the plan of reorganization of I. L. Borden Company agreed to in contract form by that corporation, by I. L. Borden individually, and by the insurance company (Exh. B, R. 89-95).

Victoria Land Company was the corporation formed by Ivey L. Borden to acquire the island at the foreclouure sale. It did so, Mr. Borden received all its stock, and it owned the island during the taxable years 1941-1943, herein in question. (R. 177-178, 179-182, 221.) Its excess profits taxes for those years are in dispute, and depend on the amount of its equity invested capital, which in turn depends on whether or not the pre-existing tax basis of the island was wiped out by the events described above. This in turn depends on whether Victoria Land Company acquired the island pursuant to a tax-free reorganization.

Neither lower court denied that if the statutory definition of "reorganization" be literally applied, the transaction qualifies as a tax-free reorganization, with the result that the pre-existing tax basis would carry over to Victoria Land Company. The government argued, however, and both lower courts held, that notwithstanding literal compliance with the statute, the transaction failed to qualify as a tax-free reorganization under the continuity of interest test evolved by this Court, for the reason that Mr. Borden was thought to have lost his proprietorship interest in the events leading up to the foreclosure sale he planned. (R. 248, 237.)

Both courts relied heavily on the fact that the price for which Mr. Borden bought in the island at the foreclosure sale was $240,500, some $337,500 less than the

face amount of the bonds. From this both courts concluded I. L. Borden Company was a bankrupt, so that its shareholder could have had no proprietary interest in its assets. (R. 236-237, 248.)

REASONS FOR GRANTING THE WRIT.

First Question.

Both lower courts held that the foreclosure sale price established the market value of the property (R. 199, 243-244; Appendix B, pp. ix, xi). In so holding, the court of appeals and also the district court rendered a decision which is in direct conflict with decisions of other courts of appeals, with provisions in Treasury Regulations, and with applicable decisions of this Court.

1. In *Helvering v. New President Corporation,* (CA 8, 1941) 122 F. 2d 92, 97, *Heiner v. Crosby,* (CA 3, 1928) 24 F. 2d 191, 193, and *Baetjer v. United States,* (CA 1, 1944) 143 F. 2d 391, 397, cert. den. 323 U.S. 772, other courts of appeals held that the amount at which property is purchased at foreclosure sales and other forced sales is no criterion of market value. Thus in the *New President* case, an income tax case, the Court of Appeals for the Eighth Circuit said (122 F. 2d at 97):

> "But the amount which the property brought at the foreclosure sale did not determine its market value since the sale price of property at a foreclosure sale is no criterion of market value."

And in *Baetjer v. United States,* supra, a condemnation case, the Court of Appeals for the First Circuit stated (143 F. 2d at 397):

"Only sales on foreclosure and similar forced transactions not on the open market are without probative force as a matter of law."

2. Treasury Regulations set forth the same rule of law which is enforced in these other circuits. Thus:

a. Regulations 105 (Estate tax), in effect when this case was tried, provide in Section 81.10:

"The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. *The value of a particular kind of property is not to be determined by a forced sale price.*" (Emphasis ours.)

b. Regulations 108 (Gift tax) in effect when this case was tried, in Section 86.19(a) contain an identical provision.

c. Regulations 118 (Income tax) in effect when this case was tried, in Section 39.113(a)(14)-1(d) contain this provision:

"In general, the fair market value of a block or aggregate of a particular kind of property *is not to be determined by a forced sales price* or by an estimate of what a whole block or aggregate would bring if placed upon the market at one and the same time, but such value should be determined by ascertaining as the basis the fair market value of each unit of the property." (Emphasis ours.)

While this statement is not the flat prohibition contained in the estate and gift tax regulations, it is nevertheless indicative of the administrative position.

3. This Court has approved and applied the rule as stated above in the extract from the *New President* opinion. This happened in *Bondholders' Committee v. Commissioner,* (1942) 315 U.S. 189, and possibly as well in *Helvering v. Alabama Asphaltic Limestone Co.,* (1942) 315 U.S. 179. The circumstances leading up to this approval are that the Solicitor General, in his brief in a case here as companion to the foregoing two (Brief for Petitioner, pp. 13-14, footnote 5, No. 286, October Term, 1941, *Helvering v. Southwest Consolidated Corporation,* (1942) 315 U.S. 194), conceded, on the authority of the *New President* decision, that the bid price at a foreclosure sale did not establish the cost of the property to the successful bidder, that cost instead being the fair market value of the property, which value was not established by the bid price at the foreclosure sale. A similar concession was made in the Solicitor General's brief in *Helvering v. Alabama Asphaltic Limestone Co.,* (1942) 315 U.S. 179 (Brief for Petitioner, pp. 4, 7, No. 328, October Term, 1941).

Adopting the Solicitor General's concession, in *Bondholders' Committee v. Commissioner,* (1942) 315 U.S. 189, 193, this Court held that the cost basis of property is not fixed by the bid price at a foreclosure sale, stating (315 U.S. at 193):[1]

> "The basis of assets bid in by a mortgage creditor on foreclosure is to be determined by the fair market value of the property."

[1]See also *Helvering v. Alabama Asphaltic Limestone Co.,* (1942) 315 U.S. 179, 180, footnote 1.

At this point this Court cited the portion of the *New President* opinion we have previously quoted (supra, p. 7). Obviously the Court did not mean to be understood as having reversed the sentence it used to convey its thought; i.e., it did not mean that the fair market value of property is to be determined by the price at which the mortgage creditor bids in the property at the foreclosure sale.

The appellate court herein did not flatly challenge the rule established by these cases and regulations. It conceded that the rule, in some circumstances, "may be" valid (Appendix B, p. ix). It declared, however, that the rule was confined to those foreclosure sales which are "in effect, closed sales where the creditors buy in" (Appendix B, p. ix). It refused to apply the rule because here a single outsider bid, forcing Mr. Borden up by some $40,000.

The rule as stated in other circuits, in the regulations and in this Court has no such qualification as the lower court has placed on it. The authoritative quotations above do not limit the rule to closed sales, or to those where the creditors bid in. The lower court's qualification of the rule misses the very point of the rule.

The rule exists because it is a necessary corollary of the basic rule, established by decisions of this Court, that "market value" is

> "the sum which . . . would in all probability result from fair negotiations between an owner who is willing to sell and a purchaser who desires to buy." (*Brooks-Scanlon Corp. v. United States,* (1924) 265 U.S. 106, 124.)

The Treasury Regulations quoted above recognize this corollary relationship:

> "The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. The value of a particular kind of property is not to be determined by a forced sale price."

A willing buyer is not enough, assuming that the presence of an outsider bidder indicates there is a willing buyer. There must also be a willing seller, able to negotiate. If the seller n ust accept the highest bid offered at that hour on that day at that particular place, he cannot negotiate. The essence of negotiation is the freedom to reject. Bids, however furious, on the courthouse steps under the hammer do not suggest that the seller could refuse to sell. Failure of the court below to grasp this point may have led to its refusal to apply the established rule, but it does not alter the fact that that refusal leads to a conflict of decision.

Second Question.

The conflict is just as real and equally serious if the decision below be more narrowly interpreted; i.e., if it be interpreted merely as holding that foreclosure sale prices may be considered as evidence of market value, along with other evidence.

At the trial the government contended that the market value of Victoria Island on December 8, 1933 was $240,-500 because: first, it was sold for that price at the foreclosure sale held that day; second, two witnesses testified

that was its market value. However, the opinions of those witnesses were based on the foreclosure sale figure. One of the witnesses stated unequivocally that he considered the foreclosure sale price "conclusive evidence of market value" (R. 226). The other witness was less open, but his written report which is among the exhibits in evidence states that he gave considerable weight to it in forming his opinion. The virtual identity of his opinion of value ($245,000; R. 225) with the foreclosure sale price ($240,500) indicates that he did rely heavily on that sale price. Plaintiff's witnesses, on the other hand, testified to values substantially in excess of $600,000 (R. 224).

Judge Roche, the trial judge, made an earnest and conscientious effort to leave no doubt on what he based his findings. His findings of fact unequivocally based the valuation on the foreclosure sale price (R. 199):

> ". . . Borden and his interest were willing buyers and that the price at which the property was sold at the foreclosure sale was its fair market value at that time, to-wit, $240,500."

In his opinion, he stated that the expert witnesses "for both sides" were well qualified (R. 252), which certainly does not imply a preference for one over the other. He also stated in his opinion (R. 252):

> "Considering the reasons for the sale, the fact that it was a voluntary foreclosure sale, the fair market value of the property as of December 8, 1933, was approximately the figure for which the property was sold, that is $240,500."

He then added (R. 252-253) that plaintiff had failed to show "that the market value was higher than the actual selling price at the foreclosure sale."

It is quite evident, therefore, that the trial judge did not consider the foreclosure sale price merely one of the items of evidence to be considered, but instead he gave it controlling weight. Moreover, the government's entire line of evidence was based on the controlling weight of the foreclosure sale price. Therefore, there is no room here for the presumption that the trial court considered only competent evidence. The appellate court evidently recognized that this is correct, for it did not mention that presumption, or in any way base its affirmance of the lower court upon it.

In holding that the foreclosure sale price is evidence tending to establish market value, the lower court decided this case in conflict with the same authorities cited in the discussion of the first question. As the First Circuit said in *Baetjer v. United States,* 143 F. 2d 391, 397, foreclosure sale prices are "without probative force as a matter of law." For that reason, they are not to be considered at all. They are not evidence.

The decision below is therefore in direct conflict with decisions of courts of appeals for other circuits, with decisions of this Court, and with Treasury Regulations.

Third Question.

In holding that a reorganization brought about by the shareholder of a debtor corporation is not tax-free because the creditors of the corporation could, if they had wanted to, have deprived the shareholder of his continuing interest, the lower court has decided this case in a manner which conflicts with decisions of other courts of appeals and with principle.

The underlying theory of the reorganization provisions is that gain or loss should not be taken into account until it has occurred as a matter of substance. Paper losses are not supposed to be permitted as deductions, by reason of the reorganization provisions.

The basis provisions are corollary to the provisions refusing to recognize gain or loss. Wherever recognition of gain or loss is postponed, basis is carried over. This is a necessary mechanic for insuring that the gain or loss will be recognized when ultimately it is realized in substance as well as in form.

The decision below conflicts with this principle. Mr. Borden suffered no real loss at the foreclosure sale on December 8, 1933. He ended up with substantially the same interest in Victoria Island as before, except that he was better off because the debts against it had been scaled down. He was not poorer in consequence of the sale but if anything richer; therefore he should not be deemed to have had a deductible loss. Yet the decision below, in holding that the pre-existing basis does not carry over, means that Mr. Borden had a deductible loss in 1933.[2]

The decision below is in conflict with decisions of other courts of appeals in *Rex Manufacturing Co., Inc. v. Commissioner,* (CA 7, 1939) 102 F. 2d 325, and *Neville Coke & Chemical Co. v. Commissioner,* (CA 3, 1945) 148 F. 2d 599, cert. den. 326 U.S. 726. The *Rex* case, while decided prior to this Court's decision in *Helvering v. Alabama Asphaltic Limestone Co.,* (1942) 315 U.S. 179, was decided

[2]The record shows that I. L. Borden Co. filed a tax return for 1933 showing a loss from this transaction (R. 30-31, 36). The record does not show or suggest that Mr. Borden reported either gain or loss on account of it.

by the Seventh Circuit after it had decided *Commissioner v. Kitselman,* (CA 7, 1937) 89 F.2d 458, which was the forerunner of the *Alabama Asphaltic* case. Moreover, in *D. W. Klein Co. v. Commissioner,* (CA 7, 1941) 123 F. 2d 871, the Seventh Circuit declared both *Kitselman* and *Rex* to be good law.

In the *Rex* case as in the instant case, the management of the debtor corporation decided that the best solution of its financial involvement was to stimulate a creditors' debt enforcement proceeding, which it did. In the *Rex* case the proceeding was a bankruptcy proceeding; in the instant case it was a foreclosure sale. In the *Rex* case the property was purchased at the bankruptcy sale on behalf of a new corporation owned by the shareholders of the old debtor corporation, and in the instant case the same was true except that the sale was a foreclosure sale and not a bankruptcy sale. In the *Rex* case the decision was that the shareholders of the debtor corporation had not lost their proprietary interest and the transaction therefore was a tax-free reorganization, whereas the lower courts herein held to the exact contrary.

The *Rex* case rests on the fact that the plan was formulated by the shareholders and carried through by their initiative. The facts in the instant case are not distinguishable. The findings of the District Court on this point are best summarized by the portion of Finding VI (R. 199) where Judge Roche found "that it was Borden's plan that the property should be sold and not the bondholders." The entire relevant portion of the findings (Finding IV, R. 197, through Finding VI, R. 199) makes it clear that this extract does not distort Judge

Roche's findings. The same can be said of his opinion, particularly the portions at R. 242-243 (115 F.Supp. at 657). Accordingly, the *Rex* case and the instant case are in direct conflict, being alike on all the essential facts but having been decided in opposite ways.

Neville Coke & Chemical Co. v. Commissioner, (CA 3, 1945) 148 F. 2d 599, cert. den. 326 U.S. 726, also conflicts with the decisions below. The court of appeals herein stated (App., infra p. viii):

> "The legal procedure employed by the creditors is not material, but the critical facts are that the old corporation was insolvent and that its creditors took steps to obtain effective command over its property."

I. L. Borden Company was insolvent, we concede, so the first half of the equation is present. The lower court held that the second half of the equation was also present because of the utilization by Mr. Borden of the creditors' foreclosure powers as a device for continuing and securing his own proprietary control. This, the lower court held, amounted to the taking of steps by the creditors to obtain effective command over the property, as the rule requires. In this respect, the decision below conflicts not only with the *Rex* case but also with the *Neville Coke* case (148 F. 2d 599, cert. den. 326 U.S. 726). In the latter case a debtor insolvent in the equity sense worked out a standby agreement with its creditors whereby the creditors were given a voice in the management and the option to acquire stock of the debtor. Some years later events forced the debtor into a 77B proceeding, in which the taxpayer, a creditor, exchanged its claims for stock and new debentures. The issue was whether the

old shareholders' proprietary interest had already passed to the creditors by reason of the insolvency of the corporation and the steps taken by the creditors to protect their interests.

The Third Circuit, unlike the courts herein, concluded that the shareholders retain the proprietary interest, and the creditors do not succeed to it, unless the creditors in fact oust the shareholders from control. The court pointed out that the taxpayer had, in the earlier standby agreement, had the opportunity to surrender its claims in exchange for stock but had chosen not to do so. It concluded (148 F. 2d at 603):

> "The fact that it had a chance to acquire a proprietary interest in its debtor does not change it from a creditor to a security holder, we think, unless and until the option is exercised."

The problem about which the Third and Seventh Circuits differ from the court below has not been presented to this Court. It is suggested but not answered by the two decisions of this Court on which the appellate court relied herein. In both of these cases (*Helvering v. Alabama Asphaltic Limestone Co.*, (1942) 315 U.S. 179; *Palm Springs Holding Corporation v. Commissioner*, (1942) 315 U.S. 185) the creditors had ousted the shareholders, taken the property over themselves, and conveyed it to a corporation they owned and in which the old shareholders had no interest. This Court held that in such circumstances, the proprietary interest in the insolvent corporation passed from shareholder to creditor. It described the creditors' action, in ousting the shareholders, as assuming "effective command" over the prop-

erty. Obviously, that expression is used in a very different way when it is applied, as it has been by the court below, to comprehend acquiescence by the creditors in a plan to pay them off and insure that the old shareholder continue to have the proprietary interest.

The problem is therefore an open one under the decisions of this Court. The courts of appeals are in conflict as to how it should be decided. The problem is a continuing one, since it is not answered by the 1954 Code. The transaction herein would be a reorganization within Section 368(a)(1)(D) of the 1954 Code, unless the unwritten continuity of interest test prevents it. On this point the conflict exists.

Fourth Question.

In a possible effort to buttress its decision, the court of appeals has stated the facts in a manner in conflict with both the evidence and the findings of fact adopted by the District Court. In so doing, it has so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision.

The court of appeals has made two statements tending to indicate that the creditors took matters into their own hands and brought about the foreclosure sale on their own initiative and for the purpose of ousting Mr. Borden. If these were the facts, they would do much to support the decision below because they would tend to show that the creditors had taken "effective command" over the property, as this Court has said is necessary to shift proprietary interest. Also, such facts would make

this case resemble *Mascot Stove Co. v. Commissioner,* (CA 6, 1941) 120 F. 2d 153, cert. den. 315 U.S. 802.

Thus, the court of appeals stated (App., infra p. vii):

> "The bondholders became convinced that the best way to salvage part of their investment was to proceed to foreclosure, and they, accordingly, notified the trustee under the bond indenture to give notice of default, to declare the principal due and payable, and to sell the island at public auction."

The quotation is a statement of half-truths, which may not have been intended but which is nevertheless misleading. The fact disclosed by both the findings and the evidence is that the Borden plan required that the bondholders give notice of default, and they did so in order to accept his offer to pay them off. Under his plan he was to retain his proprietary interest; that was the whole purpose of the plan, from his point of view.

The appellate court stated further (App., infra p. x):

> "It is claimed by appellant that the creditors merely acquiesced in Mr. Borden's plan to retain his proprietary interest; that he used their creditors' rights merely as a mechanism for effecting his plan and attaining his objective; and that, consequently, the creditors at no time took steps to obtain effective control over the property.[3] It is difficult to understand how the creditors would agree to accept only one-third of the amount of their claims in order that Mr. Borden could profit so greatly at their expense; and there is assuredly no evidence that such was their understanding or intent."

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[3]This statement of our position is quite accurate. At an earlier point in its opinion (App., infra p. vii) the court attributes to us a different theory of the case, which we did not advance before it.

The appellate court here exceeded its powers. It has no right or power to reject facts shown by the findings and by unequivocal, uncontradicted evidence.

The appellate court finds it difficult to understand the creditors' motives, because their acts seem to benefit Mr. Borden at their expense. We could only speculate about their *motives,* for the record contains no direct evidence what they were, but we established by evidence what their *acts* were. Their acts govern; the appellate court assumed powers it does not rightfully possess in disregarding both evidence and findings because it could not understand why the creditors did what the record shows they did.

The trial court found (Finding IV, p. 197, through Finding VI, p. 199):

IV.

"That Ivey L. Borden's methods of farming failed to produce sufficient revenues to service the bonds of the I. L. Borden Company, and in 1932 he decided to refinance them; that to accomplish this objective he instituted negotiations with the West Coast Life Insurance Company which insisted, before it would agree to aid Borden, that the bondholders of I. L. Borden Company be bought out, the deed of trust be liquidated, and that a new corporation be formed to accept Victoria Island, which would allow the insurance company a first mortgage on the island to secure the loan; and that accordingly on October 26, 1933 Victoria Land Company was incorporated under the laws of California to carry out the plan suggested by the West Coast Life Insurance Company; that to accomplish his objectives Borden wrote a series of letters to the bondholders of I. L. Borden Company offering to buy them out; and that those letters sug-

gested that due to the financial conditions of the island the bondholders would either have to take it over or place it up on a foreclosure sale.

V.

"That eventually it developed it would not be possible to secure the unanimous consent of the bondholders of I. L. Borden Company to the plan of direct sale of Victoria Island, and accordingly an alternative was adopted which utilized the foreclosure power of the indenture trustee as a means of saving something for the bondholders; that upon the strength of the representation that this method was the only way to save a part of their investment, the bondholders agreed and the land was put up for sale at a public auction.

VI.

"That Borden and the West Coast Life Insurance Company intended that Borden would buy in the property at $200,000 which would give the bondholders a return of approximately 33⅓ cents on the dollar, but a third party, a total stranger, entered the bidding and made the sale a real competitive auction, with the result that Borden and the insurance company, in order to purchase the land, had to outbid the third party, and to do so they raised their original figure of $200,000 to $240,500, at which price they bid in the property at the foreclosure sale thereof which took place on December 8, 1933; that it was Borden's plan that the property should be sold and not the bondholders, and that the bondholders were willing sellers and were not forced to sell; that Borden and his interest were willing buyers and that the price at which the property was sold at the foreclosure sale was its fair market value at that time, to-wit, $240,500."

To anyone who understands the evidence, it is quite clear that in these findings Judge Roche meant to restate the evidence, not to reject it.

The pertinent evidence is as follows:

1. Mr. Dan Hadsell's testimony. He was attorney for Mr. Borden and his interests from 1919 on (R. 207). He acted for Mr. Borden in negotiating and working out the details of the refinancing plan, and handled the contacts with the bondholders through the bondholders adjustment commitee (R. 212-213). He testified that (R. 213-214):

> "The general plan . . . was that he (Mr. Etienne of West Coast Life Insurance Company) would advance around $200,000 as a loan on Victoria Island and that money would be used to buy up all the bonds. An offer would be made to the bondholders for the purchase of all their bonds, and those bonds would be turned into some depository and the bonds then would be liquidated. The bond issue would be killed. The mortgage securing the bond issue would be released from the land and the West Coast Life would take a first mortgage on the property to secure the loan."

He testified further (R. 217):

> "A. Well, William R. Statz and Company were in touch with numbers of the bondholders—not all of them, but numbers of them and as we went along it began to develop that it might not be able to get all of the bondholders to consent to the proposal and if that was the case a sale would become necessary to foreclose under the bond issue to accomplish what we were trying to do and therefore, when this letter went out provision was made whereby the sale would be authorized—provision was made in the document to be

signed by the bondholders and returned to their bonds so that if less than all of the bondholders did turn in their bonds, a provision would be made whereby a sale to be accomplished to the Island under the foreclosure proceedings of a mortgage securing the bonds, and that finally did develop that way.

"Q. In the earliest days of working out this plan, was Mr. Borden or his corporation in direct contact with any of the bondholders?

"A. I had some correspondence with a few of them.

"Q. What was the substance of this correspondence?

"A. The question of the deposit of their bonds."

Also (R. 218, 220):

"Q. Did the plan at all times from the inception to the conclusion contemplate the discharge of the bonds in one form or another at the rate of 33 and a third cents on the dollar?

"A. Yes. It worked out later for certain reasons than more than that, but that was the plan.

"Q. Do you know the total number of bonds which eventually was deposited?

"A. Well, I kind of checked the figure here the last few days and got a figure of $454,000 in bonds.

"Q. Is that the face amount of the bonds?

"A. Yes.

"Q. Do you know who bore the expense of the various steps taken to get the bondholders to deposit their bonds?

"A. I. L. Borden Company.

"• • • • • • •

"Q. You have testified that the I. L. Borden Company bore the expenses of working out this plan. Why

did the I. L. Borden Company bear these expenses?

"A. Well, it was a matter for the benefit of the I. L. Borden Company.

"Q. Now, Mr. Hadsell, was the demand made by 25 per cent of the bondholders upon the trustee to sell Victoria Island pursuant to the deposit arrangement?

"A. Yes, it was.

"Q. Did the transaction throughout go according to plan?

"A. Except for the multiple amount of the bid that was finally made to purchase the property at the sale, it went according to plan.

"Q. To what are you referring?

"A. Well, on December 8th, 1933 the sale took place under the mortgage securing the bonds and it was expected at that sale that no sympathy bid to give the bondholders their 33 and a third per cent. As a matter of fact, an outsider appeared and ran up the bid on us and we finally bought the property in for $240,500."

2. Documentary evidence stipulated by both parties to be true. This is as follows, insofar as relevant:

(a) Exhs. 1-D and 1-E—Letters from the Adjustment Committee to the bondholders, transmitting Mr. Borden's proposal to them, together with the deposit agreement they must sign and return in order to accept Mr. Borden's proposal. R. 71-75.

(b) Exh. 1-F—The deposit agreement itself, which the holders of $454,000 out of the outstanding $588,000 of bonds ultimately executed and deposited. R. 75-79. Three outstanding features of the deposit agreement are its conditions that:

one, at least 51% of the bonds must be deposited; two, a sum of money sufficient to pay the bondholders at least 33⅓% of face (the amount of Mr. Borden's original proposal) must also be deposited for bid at any foreclosure sale; three, the trustee should not sell unless a bid at least equal to 33⅓% of the face amount of the bonds should be made.

(c) Exh. II—Mr. Borden's letter to the bondholders explaining his proposal and urging them to accept by signing the deposit agreement (Exh. 1-F). R. 80-83.

(d) Exh. B. The plan of reorganization, a contract between I. L. Borden Company, I. L. Borden individually, and West Coast Life Insurance Company. R. 89-95. It recites that more than 50% of the bonds are then on deposit (R. 90) and requires Mr. Borden to form a new corporation to bid in Victoria Island at the foreclosure sale, binding the Insurance Company to lend the funds therefor (R. 91-92).

The government stipulated to the exhibits and offered no evidence to rebut Mr. Hadsell's testimony. The evidence is uncontradicted, unequivocal, and not inherently improbable. Therefore the trial court could not have rejected it. *Chesapeake & Ohio Ry. Co. v. Martin,* (1931) 283 U.S. 209, 216-220; *Quock Ting v. United States,* (1891) 140 U.S. 417. The trial court did not reject it, but instead adopted the evidence in the findings. A fortiori, therefore,

the appellate court has no authority to reject the evidence. In doing so, it so far exceeded its power as to call for this Court's exercise of its supervisory jurisdiction.

CONCLUSION.

The writ of certiorari should be issued.

Respectfully submitted,

ARTHUR H. KENT,

VALENTINE BROOKES,

Attorneys for Petitioner.

San Francisco, California,

December 1, 1955.

(Appendices A and B Follow.)

Appendix A

STATUTES.

Revenue Act of 1932:

Sec. 112(i). *Definition of Reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of Control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Sec. 112(b)(4). *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

Sec. 113(a)(7). *Transfers to Corporation Where Control of Property Remains in Same Persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

Internal Revenue Code:

Sec. 113(a)(12). *Basis Established by Revenue Act of 1932.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932, 47 Stat. 199, was prescribed by section 113(a)(6), (7), or (9) of such Act, then for the purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

Sec. 718(a)(2). (a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

* * * * * * *

(2) *Property Paid In.*—Property (other than money) previously paid in (regardless of the time paid in) for stock, or as paid-in surplus, or as a contribution to capital. Such property shall be included in an amount equal to its basis (unadjusted) for determining loss upon sale or exchange. If the property was disposed of before such taxable year, such basis shall be determined under the law applicable to the year of disposition, but without regard to the value of the property as of March 1, 1913. If the property was disposed of before March 1, 1913, its basis shall be considered to be its fair market value at the time paid in. If the unadjusted basis of the property is a substituted basis, such basis shall be adjusted, with respect to the period before the property was paid in, by an amount equal to the adjustments proper under section 115(1) for determining earnings and profits; Sec. 760(a). (a) *Definitions, Etc.*—For the purposes of this section—

(1) *"Exchange," "Transferor," and "Transferee."*—The term "exchange" means a transaction by which one corporation (hereinafter called "transferee") receives property of another corporation (hereinafter called "transferor") and the basis of the property received, in the hands of the transferee, for the purposes of section

718(a) is determined by reference to the basis in the hands of the transferor.

(2) *Determination of Basis of Property Received.*—The basis, in the hands of the transferee, of the property of the transferor received by the transferee upon the exchange shall be determined in accordance with section 718(a).

Appendix B

United States Court of Appeals
for the Ninth Circuit

Wells Fargo Bank & Union Trust Co., as Executor of the Estate of Ivey L. Borden, Deceased, Appellant, vs. United States of America, Appellee.	No. 14,270 Jun. 16, 1955

Upon Appeal from the United States District Court for the Northern District of California, Southern Division

Before: ORR, McALLISTER, and FEE, Circuit Judges

THOMAS F. McALLISTER, Circuit Judge:

Appellant, as executor of the estate of Ivey L. Borden, deceased, appeals from a judgment denying recovery for overpayment of federal excess profits taxes. The issue before us is whether a transaction in which a certain corporation, of which appellant's decedent, Mr. Borden, was sole stockholder, acquired the properties of a predecessor corporation of which he was also sole stockholder, constituted a tax-free reorganization. The district court held that it was not a tax-free reorganization within the meaning of Section 112(i) of the Revenue Act of 1932.

The background of the controversy is as follows: Mr. Borden, in 1929, was the individual owner of Victoria Island, with an area of 7,300 acres lying in the delta of the San Joaquin River in California. The land was subject to a reclamation district bond issue of $600,000, secured by the island. In 1929, Mr. Borden found it necessary to secure refinancing of the reclamation bond issue and, accordingly, organized I. L. Borden Company, a corporation, to which he transferred Victoria Island in exchange for all its capital stock less qualifying shares; and he induced the reclamation bondholders to exchange their bonds for bonds of the I. L. Borden Company of the same face value.

In 1932, the new corporation was receiving insufficient revenue from the island to take care of the interest on the bonds, and refinancing was again necessary. Negotiations during that year between the corporation and West Coast Life Insurance Company resulted in an agreement that West Coast would make the necessary loan provided that the bondholders of the corporation be bought out, the deed of trust liquidated, and a new corporation formed to hold the island, which would allow West Coast a mortgage to secure the loan. In order to carry out this proposed agreement, a new corporation was organized under the name of Victoria Land Company. During the course of these events, Mr. Borden communicated with the bondholders of the I. L. Borden Company, offering to buy them out, and then later suggested that due to the financial condition of the island, the bondholders would either have to take the island over or proceed to a foreclosure sale.

The bondholders became convinced that the best way to salvage part of their investment was to proceed to foreclosure, and they, accordingly, notified the trustee under the bond indenture to give notice of default, to declare the principal due and payable, and to sell the island at public auction.

Mr. Borden planned with West Coast to buy the island at the foreclosure sale for $200,000, but, unexpectedly, a stranger appeared at the sale and entered the bidding, with the result that Mr. Borden and West Coast had to go up to $240,500 in order to outbid the stranger and to buy in the property. Thereupon, title to the property was forthwith transferred to the new Victoria Land Company, which held it during the tax years and until its dissolution in 1946.

Appellant's theory, on this review, is that, at the time of the foreclosure of the island property its fair market value was in excess of the price at which it was sold at foreclosure; that this excess represented the equity in that property remaining in the Borden Company after the foreclosure, and was allocable to decedent as sole stockholder; that it was this equity which was transferred by the Borden Company at that time to the Victoria Land Company in which decedent was also sole stockholder; and that, because of this, there was a tax-free reorganization rather than an outright sale of the property, and that appellant's decedent is, accordingly, entitled to recovery of overpayment of the federal excess profits taxes because of the tax-free nature of the transaction.

Section 112(i) of the Revenue Act of 1932, in so far as here pertinent, provides:

> "(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of * * * substantially all of the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, * * *."

There is no reorganization when the transferor does not acquire a proprietary interest in the purchasing company. *Pinellas Ice Co. v. Commissioner,* 287 U. S. 462; *Le Tulle v. Scofield,* 308 U. S. 415. The proprietary interest shifts from stockholders of a corporation to its creditors, not later than the time when the creditors take steps to enforce their demands against their insolvent debtor. In ascertaining whether there is a shift of proprietary interest from stockholder to creditor, the determining and controlling factors are the debtor's insolvency and an effective command by the creditors over the property. *Helvering v. Alabama Asphaltic Limestone Co.,* 315 U. S. 179. The legal procedure employed by the creditors is not material, but the critical facts are that the old corporation was insolvent and that its creditors took steps to obtain effective command over its property. *Palm Springs Holding Corp. v. Commissioner,* 315 U. S. 185.

The district court found that when the first mortgage bondholders of the Borden Company demanded that the

trustee under the trust indenture sell the property known as Victoria Island, which was security for their bonds, that company was insolvent in an equity sense. The mortgage was for $600,000. The sale at foreclosure brought $240,500. The district court found that $240,500 was the fair market value of the property at that time. One of the government expert witnesses testified that the fair market value of the property was $240,000; another testified that it was $240,500. Moreover, this was the amount paid as a result of competitive bidding at a public sale.

It is strenuously maintained by appellant that the sale price on the foreclosure is no evidence of the value of the property as of that time, and in support of this contention, he cites *Helvering v. New President Corp.*, 122 F. 2d 92 (C.C.A. 8). Under given circumstances, this may be true, but the authority above cited does not lay down such a rule as absolute in all cases. Many foreclosure sales are, in effect, closed sales where creditors buy in. Here, the public participated. The final price which was bid in the instant case was considerably higher than Mr. Borden represented the property could be sold for, and, as heretofore mentioned, resulted from the bidding of an outsider. Taking all of the circumstances of this case into consideration, we cannot say that it was error for the district court to consider, with other testimony, the sale price as some evidence of the fair market value of the property at the time of the sale. The findings of fact by the district court that the company was insolvent and that the fair market value of its property at the time of sale was $240,500 were fully supported by the record.

Appellant contends that the foreclosure was merely part of a plan of reorganization in which the bondholders followed the advice and direction of Mr. Borden in agreeing to such a proceeding.

It is claimed by appellant that the creditors merely acquiesced in Mr. Borden's plan to retain his proprietary interest; that he used their creditors' rights merely as a mechanism for effecting his plan and attaining his objective; and that, consequently, the creditors at no time took steps to obtain effective control over the property. It is difficult to understand how the creditors would agree to accept only one-third of the amount of their claims in order that Mr. Borden could profit so greatly at their expense; and there is assuredly no evidence that such was their understanding or intent. As the district court remarked, the fact that the alleged plan of reorganization did not make any reference to the purported equity remaining in the mortgagors, or provide for the transfer of such an important equitable interest to the new corporation in exchange for its capital stock, supports the government's view that no equitable interest remained in Borden.

The evidence shows, not a plan of reorganization, but, rather, various proceedings resorted to when Mr. Borden failed to refinance the outstanding bond issue. It is clear that the entire proprietary interest in the property of the corporation shifted from Borden, the sole stockholder, to the first mortgage bondholders when the latter took effective command over the disposition of the property prior to the foreclosure sale.

Since the fair market value of the property was equivalent to the price paid at the sale, there was nothing of value left in the Borden Company after the foreclosure allocable to decedent as sole stockholder, that the new company, of which Mr. Borden was also sole stockholder, received by way of transfer. The foreclosure had divested the Borden Company of whatever legal or economic interest it had in the property. The new company acquired from the Borden Company the property in question, solely for cash, at a foreclosure sale under a bond indenture. The old continuity of interest was broken; the bondholders acquired no interest in the new corporation; and Mr. Borden, who no longer possessed any interest in the property of the old corporation, became the sole stockholder and proprietor of the new corporation. It is plain that, under these circumstances, there was no tax-free reorganization within the meaning of the statute.

In accordance with the foregoing, the judgment of the district court is affirmed in accordance with the opinion of Judge Roche.

(Endorsed:) Opinion. Filed Jun. 16, 1955.

Paul P. O'Brien, Clerk.

United States Court of Appeals
for the Ninth Circuit

Wells Fargo Bank & Union Trust Co., as Executor of the Estate of Ivey L. Borden, Deceased, Appellant, vs. United States of America, Appellee.	No. 14,270

JUDGMENT

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

(Endorsed) Judgment.

Filed and Entered: June 16, 1955.

Paul P. O'Brien, Clerk.

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 551

WELLS FARGO BANK & UNION TRUST CO., AS EXECUTOR OF THE ESTATE OF IVEY L. BORDEN, DECEASED, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 241–253) is reported at 115 F. Supp. 655. The opinion of the Court of Appeals (R. 233–237) is reported at 225 F. 2d 298.

JURISDICTION

The judgment of the Court of Appeals was entered on June 16, 1955. (R. 238.) A petition for rehearing was filed on July 15, 1955, and denied on September 6, 1955. (R. 239.) The petition for a writ of certiorari was filed on December 3, 1955. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Did the transfer of Victoria Island by I. L. Borden Company to Victoria Land Company in 1933 fail to qualify as a tax-free reorganization under Section 112 of the Revenue Act of 1932, as the lower courts held, because the requisite continuity of proprietary interest was absent?

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(12) *Basis established by Revenue Act of 1932.*—If the property was acquired, after February 28, 1913, in any taxable year beginning prior to January 1, 1934, and the basis thereof, for the purposes of the Revenue Act of 1932, 47 Stat. 199, was prescribed by section 113 (a) (6), (7), or (9) of such Act, then for the purposes of this chapter the basis shall be the same as the basis therein prescribed in the Revenue Act of 1932.

* * * * *

(26 U. S. C. 1952 ed., Sec. 113.)

Revenue Act of 1932, c. 209, 47 Stat. 169.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of

the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(i) *Definition of Reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from

a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. * * *

* * * * *

STATEMENT

This litigation was instituted to recover excess profits taxes paid for the years 1941 through 1943

by the Victoria Land Company ("Victoria").[1] Victoria had computed its excess profits credit for the years in question by the invested capital method, using as the basis of its sole corporate asset, Victoria Island, the price paid therefor at a foreclosure sale on December 8, 1933. It is contended, however, in this litigation that Victoria was entitled to use the basis of the Island in the hands of the predecessor corporation, I. L. Borden Company, because Victoria acquired the Island in a tax-free reorganization. (R. 242.)

The material facts, as stipulated (R. 37–50) and as found by the District Court (R. 195–201), may be summarized as follows:

At the beginning of 1929, Ivey L. Borden was the individual owner of Victoria Island, an island of 7,300 acres in the delta of the San Joaquin River in California, his equity therein being subject to a reclamation district bond issue of $600,000 secured by the island. At that time Borden was faced with the necessity of refinancing the bond issue. Accordingly, on February 16, 1929, he organized I. L. Borden Company, a corporation; transferred Victoria Island to the corporation in exchange for all of its capital stock less qualifying shares; and induced the reclamation bondholders to exchange their bonds for bonds of the corporation totaling $600,000 in

[1] The District Court sustained (R. 201), and the Government concedes, petitioner's standing to prosecute the claim.

face amount and maturing January 1, 1949. (R. 38–39, 197.)

In 1932, refinancing was again necessary since the I. L. Borden Company was receiving insufficient revenues from Victoria Island to service the bonds. (R. 197.) Interest payments on the bonds were in default beginning with those due on January 1, 1932. (R. 104.) Mr. Borden opened negotiations for refinancing with West Coast Life Insurance Company which agreed to make the needed loan, provided that the bondholders of I. L. Borden Company were bought out, that the deed of trust was liquidated, that a new corporation was formed to hold Victoria Island, and that this corporation would give West Coast a first mortgage on the Island to secure the loan. Accordingly, Victoria Land Company was incorporated on October 26, 1933, to take title to Victoria Island. (R. 197–198.)

Meanwhile, Mr. Borden was writing letters to the bondholders of the I. L. Borden Company, offering to buy them out and suggesting that the financial situation was such that the bondholders would either have to take over the Island themselves or allow a foreclosure sale. It developed thereafter that it would not be possible to secure the unanimous consent of the bondholders to the direct sale of Victoria Island; but the bondholders were ultimately persuaded, as Mr. Borden urged, that sale of the Island under the foreclosure power was the best means of salvaging

part of their investment. (R. 198.) Consequently, on October 18, 1933, the bondholders demanded that the indenture trustee sell the property (Victoria Island) which was security for their bonds (R. 201); and the trustee, by written notice to I. L. Borden Company, declared the principal of the bonds to be due and payable because of default, preliminary to selling the Island at public auction (R. 132–133).

Mr. Borden and West Coast planned to buy in the Island at the ensuing foreclosure sale for $200,000, which would have given the bondholders approximately 33 cents on the dollar; but a stranger to this scheme entered the bidding at the sale, which was held on December 8, 1933, with the result that Borden and West Coast had to raise their bid to $240,500 in order to buy in the property. Title to the Island was forthwith transferred to the Victoria Land Company, which held it during the tax years in question. (R. 198–200.)

I. L. Borden Company was insolvent in an equity sense when the bondholders demanded that the indenture trustee sell the Island. (R. 201.) The bondholders realized 36 cents on the dollar for their bonds through the ensuing foreclosure sale. (R. 199.) No provision was made for the participation by these bondholders in the new corporation, Victoria Land Company, either as shareholders or as security holders. (R. 200.) The foreclosure sale divested the I. L. Borden Company of whatever legal or economic interest it had

in the Victoria Island property and it had, therefore, nothing of value after the sale to transfer to Victoria Land Company in exchange for shares of the latter's stock. (R. 199.)

At the foreclosure sale the bondholders were willing sellers and not forced to sell, and Borden and West Coast were willing buyers. The price paid for the Island was its fair market value at that time, to wit, $240,500. (R. 199.)

The District Court found as an ultimate fact that Victoria Land Company did not acquire Victoria Island pursuant to any plan of reorganization of I. L. Borden Company, but acquired the property solely for cash at the foreclosure sale thereof from the trustee under the bond indenture of I. L. Borden Company. (R. 199–200.)

ARGUMENT

1. The decisive question in this litigation is whether Victoria Land Company acquired Victoria Island from I. L. Borden Company in a tax-free reorganization under Section 112 of the Revenue Act of 1932. If it did not, as both the lower courts held, then it is clear that the basis of the property to Victoria Land Company, under Section 113 (a) of the 1939 Code, *supra,* is cost—namely, the sum of $240,500 which was paid on Victoria's behalf to buy in the property at the foreclosure sale. Whether there was a tax-free reorganization turns upon a still narrower issue:

Was there present the continuity of proprietary interest required for such a reorganization?

The continuity of interest requirement for tax-free reorganizations, while not explicitly set forth in Section 112 of the 1939 Code or its predecessors, has been evolved by this Court in a series of decisions as a necessary gloss on the statutory provisions. The criteria established by these decisions, we submit, have been correctly applied by the lower courts to the facts of the instant case in arriving at their ultimate conclusion that there was no continuity between I. L. Borden Company and Victoria Land Company.

Briefly stated, the continuity of interest rule requires that, for a reorganization to qualify as tax-free, the owners of the enterprise prior to the reorganization must have a substantial proprietary stake in the reorganized corporation. Normally, of course, it is the stockholders who possess the proprietary interest in the old corporation and must therefore have the stockholding interest in the new, if the requisite continuity of interest is to be effected. *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462; *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378; *LeTulle* v. *Scofield,* 308 U. S. 415. However, the proprietary interest shifts from a corporation's stockholders to its creditors when the corporation becomes insolvent and the creditors take steps to obtain effective command over the assets; where this shift has occurred, the continuity of interest requirement is not satisfied un-

less the creditors acquire a substantial stockholding interest in the new corporation. *Helvering* v. *Limestone Co.*, 315 U. S. 179; *Palm Springs Corp.* v. *Commissioner*, 315 U. S. 185; and *Bondholders Committee* v. *Commissioner*, 315 U. S. 189. The tests of insolvency and creditor control are to be flexibly and realistically applied. As this Court held in *Palm Springs Corp.* v. *Commissioner*, *supra* (p. 186), the corporation need only be insolvent "in the equity sense," and (pp. 188–189) the nature of the procedure employed by the creditors to obtain command of the corporate assets is immaterial.

In the case at bar, the old corporation was insolvent, as petitioner expressly concedes (Pet. 16). The creditors of the corporation were thus the equitable owners of the sole corporate asset, Victoria Island; and they took effective steps to obtain command of this property by instituting foreclosure proceedings and having the property sold at foreclosure. But the creditors did not acquire any interest in the new corporation, Victoria Land Company, but, instead, received only cash to the extent of 36 cents on the dollar. In view of these facts, it is perfectly plain that there was no continuity of interest as between the old and the new corporation. *Mascot Stove Co.* v. *Commissioner*, 120 F. 2d 153 (C. A. 6th), certiorari denied, 315 U. S. 802; *Templeton's Jewelers* v. *United States*, 126 F. 2d 251 (C. A. 6th). Far from there being a true corporate reorganiza-

tion, there was merely a sale of Victoria Island by its owners, the creditors of I. L. Borden Company, to purchasers acting on behalf of Victoria Land Company.[2] As any other purchaser of property, Victoria Land Company must use its cost as the basis of the property.

Petitioner's argument that there was a tax-free corporate reorganization under the taxing statute rather than a mere sale of corporate property rests on infirm grounds. Conceding that there would be (Pet. 18) "much to support the decision below" if the creditors had instituted the foreclosure proceedings on their own initiative, petitioner seems to be arguing that the creditors did not take command of the property because, as it contends (Pet. 18–26), the sole stockholder of the old corporation had suggested foreclosure to them as one of the means of realizing on their claims against the corporation.

Where the creditors of an insolvent corporation, possessing, under the full priority rule, the only real interest in the corporate assets, see fit to cause a sale of that property in order to realize on their claims to the fullest possible extent, they have taken effective command over the assets. Even if the impetus for their action was supplied by someone else's suggestion, that does

[2] As petitioner recognizes (Pet. 14, fn. 2), the predecessor company did not consider that a nontaxable transfer had taken place but, instead, treated the transaction on its 1935 return as resulting in a recognized loss.

not make their control over the assets any less complete or detract from the existence of their proprietary interest. Surely, the taxable nature of the transaction does not turn on whether the idea of foreclosing did or did not originate with the creditors. Therefore, unless the foreclosing creditors obtain a proprietary interest in the new corporation, continuity is broken and there can be no tax-free reorganization. As we have shown, such continuity is lacking here.

2. Petitioner is wrong in claiming (Pet. 14–17) that *Rex Mfg. Co.* v. *Commissioner,* 102 F. 2d 325 (C. A. 7th), and *Neville Coke & Chemical Co.* v. *Commissioner,* 148 F. 2d 599 (C. A. 3d), certiorari denied, 326 U. S. 726, are in conflict with the decision below. These cases fail to support petitioner's position in any respect. Both cases were decided prior to this Court's decision in the *Limestone Co., Palm Springs Corp.* and *Bondholders Committee* cases, cited and discussed above. Neither case was concerned with the continuity of proprietary interest requirement, in its application to reorganization situations in which the old corporation was insolvent. Moreover, neither case dealt with the proprietary interest of creditors who have instituted foreclosure proceedings and brought about a sale of the corporate assets for cash. Finally, there is nothing in either case to support the notion that corporate creditors do not obtain effective control over the assets of the corporation by foreclosure proceed-

ings if that course of action is suggested to them by others.

3. The first two issues posed by petitioner (Pet. 2, 7–13), relating to fair market value, are not germane. If, as we contend, the courts below were correct in holding that the transactions in question failed to qualify as a tax-free reorganization, then, as we have already observed, the basis of the property to Victoria Land Company was the cash purchase price of $240,500 paid at the foreclosure sale; and the precise fair market value of the property is without significance. And even if petitioner were correct in contending that there was a tax-free reorganization, the fair market value of the property at the time of transfer would be equally irrelevant; for the basis of the property would be that of the transferor, I. L. Borden Company, properly adjusted. See Section 113 (a) (12) of the 1939 Code, *supra,* and Section 113 (a) (7) of the Revenue Act of 1932, *supra.* Consequently, these questions have no bearing on the decisive reorganization question and require no discussion.[3]

[3] It was necessary for the lower courts to pass upon the question of fair market value because petitioner's position was different below. As the District Court noted (R. 249), it was petitioner's position in that forum that I. L. Borden Company still had something of value to transfer to Victoria Land Company after payment to the bondholders of the net proceeds of the foreclosure sale. Subsequently, the Court of Appeals spelled out this position as follows (R. 234–235):

"Appellant's theory, on this review, is that, at the time of the foreclosure of the island property, its fair market value

CONCLUSION

The decision below is correct. There is no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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was in excess of the price at which it was sold at foreclosure; that this excess represented the equity in that property remaining in the Borden Company after the foreclosure, and was allocable to decedent as sole stockholder; that it was this equity which was transferred by the Borden Company at that time to the Victoria Land Company in which decendent was also sole stockholder; and that, because of this, there was a tax-free reorganization rather than an outright sale of the property * * *."

In view of this argument, and of petitioner's denial below that I. L. Borden Company was insolvent in the sense required for shift of interest, the question of fair market value was obviously material.

Petitioner's present denial (Pet. 19, fn. 3), that the residual equity argument was advanced in the Court of Appeals cannot alter the fact that that Court thought it was being advanced, and passed upon the fair market value question in the light of that understanding.

Petitioner's present concession that the predecessor corporation was insolvent and that the creditors could have taken command over the property (although petitioner denies that they did) make it unnecessary to discuss here the fair market value of the property.

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